

## Economic Outlook for FY2009 and FY2010

*(revised to reflect the Second Preliminary Quarterly Estimates of GDP for the Jul-Sep quarter of 2009)*

December 2009

**Key points of Mizuho Research Institute's (MHRI) outlook on the economy in FY2009 and FY2010**  
(reflecting *The Second Preliminary Quarterly Estimates of GDP (2<sup>nd</sup> QE)* for the Jul-Sep quarter of 2009)

In Japan, measures such as the "child allowance" will serve to drive private demand while the "reduction of wasteful spending" will drag down public demand, resulting in more or less flat domestic demand growth in FY2010. In the meantime, the ongoing rise of exports amid the global economic recovery driven mainly by the Asian economies will serve to underpin domestic production and keep the Japanese economy from falling into a double dip recession.

### <The Japanese Economy>

**FY2009** -2.8% (previous outlook -2.9%)

The momentum will gradually wane along with the fading impact of policy measures

**FY2010** +1.0% (previous outlook +0.9%)

Even though domestic demand will ebb and flow, exports will underpin the economy

### <The US Economy>

Progress of disinflation amid the weak recovery of final demand

**2009** -2.6% (previous outlook -2.5%)

**2010** +1.9% (previous outlook +1.9%)

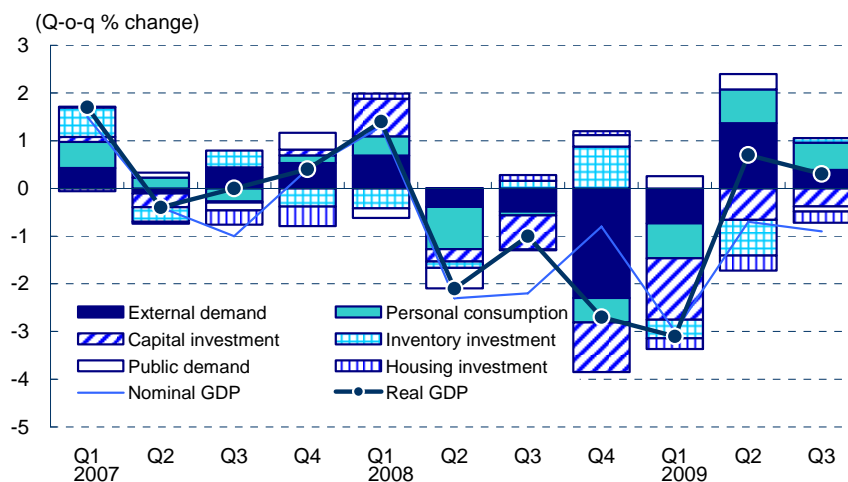
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# I. The current state of the Japanese economy

## Jul-Sep quarter real GDP growth slashed in 2<sup>nd</sup> QE

The *Second Preliminary Quarterly Estimates of GDP* (“2<sup>nd</sup> QE”) for the Jul-Sep quarter of 2009 released on December 9, 2009 revealed a sharp downward revision of Japan’s real GDP growth to +0.3% q-o-q (+1.3% p.a.) from +1.2% q-o-q (+4.8% p.a.) in the *First Preliminary Quarterly Estimates of GDP* (“1<sup>st</sup> QE”) (**Chart 1**). Looking closer at each of the components of demand, capital investment was revised down from +1.6% q-o-q in the 1<sup>st</sup> QE to -2.8% q-o-q in the 2<sup>nd</sup> QE, to reflect the results of the *Financial Statements Statistics of Corporations by Industry*. Furthermore, given the sharp contraction of stock accumulation, the contribution by private sector inventory investment to quarterly real GDP growth was also revised down sharply from +0.4% pt in the 1<sup>st</sup> QE to +0.1% pt in the 2<sup>nd</sup> QE. Even though personal consumption was revised up slightly from +0.7% q-o-q to +0.9% q-o-q, to reflect the change of seasonally adjusted data released in the FY2008 revised estimates of GDP, the contribution by domestic private sector demand to quarterly real GDP growth turned out to be considerably weaker (+0.8% pt → +0.0% pt). Furthermore, given the downward revisions of both public investment (-1.2% q-o-q → -1.6% q-o-q) and government consumption (+0.4% q-o-q → -0.1% q-o-q), the contribution by domestic demand - combining both public and private demand - was revised down from +0.8% pt to -0.1% pt. The contribution by external demand remained unchanged from the 1<sup>st</sup> QE at +0.4% pt. Due in part to the upward revision of the FY2008 revised estimates of GDP, the GDP deflator was revised down sharply from +0.2% y-o-y to -0.5% y-o-y, confirming that the Japanese economy had fallen into a deflationary trend from the Apr-Jun quarter (-0.5% y-o-y). As with Japan’s growth in real terms, nominal GDP growth was also revised down sharply to -0.9% q-o-q from -0.1% q-o-q the 1<sup>st</sup> QE.

[ Chart 1: Japan’s GDP growth ]



Source: Made by MHRI, based upon Cabinet Office, *Preliminary Quarterly Estimates of GDP*.

**The 2<sup>nd</sup> supplementary budget will only have limited effect in bolstering growth**

Subsequent to the Cabinet's approval of an emergency economic stimulus package on December 8<sup>th</sup>, a second supplementary budget worth JPY7.2 trillion in national spending and JPY24.4 trillion in terms of project costs will be submitted to the next ordinary Diet session. In terms of its economic impact, the second supplementary budget may be commended for extending the duration of various measures which had heretofore underpinned the economy, such as the alleviation of eligibility for the employment adjustment subsidy and the subsidies to stimulate demand for environment-friendly appliances in the Eco-Point Program and demand for fuel-efficient cars in the Eco-Car Program. Negative impacts from their termination may be avoided. Even so, since the direct creation of demand only amounts to JPY0.5 trillion in provision of support toward regional public works, the package lacks power as additional stimulus upon growth. Although the housing market version of the Eco-Point Program and the time-limited reduction of the Flat 35 mortgage loan rates may have some effect in raising the incentive to purchase homes, the ambiguity of the details coupled with the deterioration of labor market conditions and widespread uncertainties regarding the future provide doubts as to whether it will serve as a trigger for home purchases. Given the time necessary for the rise of sales to feed through to new housing starts and be reflected in GDP-based housing investment, it will not provide the impetus of the sort necessary to provide direct positive effect upon the economy from the turn of the New Year when the negative impact of the suspension of the first supplementary budget starts to emerge.

## **II. Forecast of the Japanese economy in FY2009 and FY2010**

**Outlook on FY2009 real GDP growth: -2.8%**

In view of developments which have unfolded since the release of our previous *Economic Outlook* (on November 18, 2009), we have revised our outlook on real GDP growth in FY2009 to -2.8% (previous outlook -2.9%) (**Chart 2**). On the basis of our judgment that the official releases on capital investment and inventory investment growth in the 1<sup>st</sup> *QE* turned out to be stronger than actual activity, we assumed to a certain degree that they would be revised downward in the 2<sup>nd</sup> *QE* or that there would be a substantial backlash from the Oct-Dec quarter onward. Thus, the sharp downward revision of Jul-Sep quarter growth in the 2<sup>nd</sup> *QE* is not a factor possessing such a large impact upon our outlook on growth in FY2009. One of the major reasons for the minor revision to our outlook is the release of the revised estimates of GDP for FY2008. Firstly, we took into consideration the upward revision of the carry-over of growth (the rate of growth which would be achieved if the economy remains unchanged throughout FY2009 at the level of GDP in the Jan-Mar quarter of 2009) from -4.2% to -3.8%. The second reason stems from the extension of the Eco-Car Program subsidies until September 2010 since we had assumed that there would be a last-minute

rush to purchase cars in the Jan-Mar quarter on the presupposition that the Eco-Car Program would be terminated at the end of the fiscal year in March 2010. Given the extension of the program, we have fine-tuned our outlook to preclude the last-minute rush of car purchases and have revised down our outlook on personal consumption (since our previous outlook was based upon the assumption that the Eco-Point Program would be continued, the developments regarding the supplementary budget do not affect our economic outlook). The minor upward revision of our outlook on growth stems from the fact that the impact of the carry-over of growth is slightly larger than the other factors.

**FY2010 real GDP growth is revised to +1.0%**

Looking forward on the basis of the foregoing premises, our outlook on real GDP growth in FY2010 has been revised to +1.0% (previous outlook: +0.9%). Given the Democratic Party of Japan's (DPJ) key policy initiatives - the abolishment of the provisional tax rates from April and the child allowance from June - we expect the rise of real purchasing power mainly in the household sector from the Apr-Jun quarter of 2010. Despite the continuation of sluggish income growth in both the corporate and household sectors, the odds are high that private demand will be pushed up, driven mainly by personal consumption. In contrast, public demand is predicted to fall sharply due to the reduction of public investment, leaving overall domestic demand growth more or less flat. Therefore, the course of Japan's economy will depend upon the overseas economies. At present, the odds are high that Japan's exports will continue to grow along with global economic recovery driven mainly by the Asian economies. This, in turn, will prop up Japan's domestic output and keep the Japanese economy from falling into a so-called "double dip recession".

**Forecasts of prolonged deflation due to persistent output gap**

The output gap (the gap between actual GDP and potential GDP) estimated by MHRI stood at -6.3% as of the Jul-Sep quarter of 2009 (**Chart 3**). If the Japanese economy proceeds as set forth in our outlook, the output gap will contract since the economy is predicted to grow at a pace surpassing the potential rate of GDP growth. Even so, an excess supply of approximately 5% will remain as of the end of FY2010. Taken together with the decline of the expected rate of inflation (**Chart 4**), the odds are high that deflation will linger over a prolonged period of time. Amid the limited leeway for further fiscal spending, expectations will tend to rise toward more monetary easing by the Bank of Japan (BOJ), serving as downward pressures upon long-term interest rates. Even so, judging from the fact that the principal cause of the current deflationary trends is the shortage of demand, monetary easing will not provide the entire solution. Since fiscal spending to push up demand would not be sustainable either, measures to encourage the adjustment of excessive supply might be worth consideration over the short term. Some of the plausible measures would be to encourage the adjustment of excessive stock among companies by easing the limit on depreciation along with a further reinforcement of safety nets for a possible rise of

unemployment in the course of the labor stock adjustment process. More fundamentally, the high road to eradicate deflation would be to stimulate private demand by raising corporate growth expectations and dispel household uncertainties toward the future.

[ Chart 2: Outlook on the Japanese economy ]

		FY2008	FY2009	FY2010	2009				2010				2011
					Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1
GDP (real)	Q-o-q % ch	-3.7	-2.8	1.0	-3.1	0.7	0.3	0.4	0.3	-0.2	0.6	0.3	0.5
	Q-o-q% ch p.a.	--	--	--	-11.9	2.7	1.3	1.4	1.1	-0.9	2.2	1.3	2.1
Domestic demand	Q-o-q % ch	-2.7	-2.8	0.0	-2.3	-0.7	-0.1	0.0	0.0	-0.5	0.4	0.1	0.4
Private sector demand	Q-o-q % ch	-3.1	-4.6	0.6	-3.4	-1.3	0.1	-0.5	-0.2	-0.3	1.1	0.5	0.6
Personal consumption	Q-o-q % ch	-1.8	0.4	1.0	-1.2	1.2	0.9	-0.2	0.1	0.0	0.8	0.2	0.2
Housing investment	Q-o-q % ch	-3.7	-18.5	-1.5	-6.4	-9.4	-7.9	-1.7	-2.1	1.1	2.2	-0.1	0.7
Capital investment	Q-o-q % ch	-6.8	-17.3	-1.2	-8.4	-4.6	-2.8	-1.6	-1.5	-0.6	0.7	1.4	2.2
Inventory investment	Q-o-q contribution, % pt	-0.1	-0.5	0.1	-0.4	-0.7	0.1	0.0	0.1	-0.2	0.2	0.0	0.0
Public sector demand	Q-o-q % ch	-1.3	3.2	-2.0	1.1	1.3	-0.4	1.8	0.3	-1.1	-1.6	-1.0	-0.4
Government consumption	Q-o-q % ch	-0.1	2.0	1.8	0.7	0.3	-0.1	1.1	0.8	0.3	0.2	0.3	0.5
Public investment	Q-o-q % ch	-6.6	10.8	-21.9	3.7	6.3	-1.6	5.2	-2.3	-7.9	-11.6	-9.0	-6.2
External demand	Q-o-q contribution, % pt	-1.2	-0.1	0.9	-0.7	1.4	0.4	0.2	0.3	0.2	0.1	0.2	0.1
Exports	Q-o-q % ch	-10.4	-12.6	10.1	-21.3	6.5	6.5	4.0	3.0	1.8	1.5	1.5	1.5
Imports	Q-o-q % ch	-4.4	-12.0	3.5	-15.0	-3.4	3.3	2.2	1.0	0.2	0.6	0.0	0.8
GDP (nominal)	Q-o-q % ch	-4.2	-3.8	-0.5	-3.0	-0.7	-0.9	1.7	-0.4	-1.7	-0.2	2.3	-0.1
GDP deflator	Y-o-y % ch	-0.4	-1.1	-1.5	0.3	-0.5	-0.6	-0.8	-2.3	-1.9	-1.6	-1.3	-1.2
Domestic demand deflator	Y-o-y % ch	0.4	-2.2	-1.4	-1.3	-2.6	-2.9	-1.9	-1.2	-1.1	-1.5	-1.6	-1.5

Note: The rates of change above are based upon actual amounts and hence may differ from the rates of change in public releases.

Source: Made by MHR based upon Cabinet Office, *Preliminary Quarterly Estimates of GDP*.

		FY2008	FY2009	FY2010	2009				2010				2011
					Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1
Industrial production	Q-o-q % ch	-12.6	-10.1	6.3	-22.2	8.3	7.4	4.5	1.7	0.2	0.7	0.1	0.7
Ordinary profits	Y-o-y % ch	-39.0	-26.4	24.1	-69.0	-53.0	-32.4	-24.0	81.3	37.6	34.0	23.2	2.9
Nominal labor compensation	Y-o-y ch	-0.3	-4.1	-1.0	-2.8	-4.6	-3.8	-5.2	-2.4	-1.4	-1.0	-1.2	-0.2
Unemployment rate	%	4.1	5.4	5.3	4.4	5.2	5.5	5.3	5.5	5.5	5.4	5.3	4.9
New housing starts	p.a., 10,000 units	103.9	74.6	80.5	90.4	76.2	70.7	73.9	76.5	79.7	80.6	82.9	86.1
Current account balance	p.a., JPY tril	12.3	15.1	19.3	7.2	15.8	14.9	18.5	10.2	14.0	18.4	25.6	15.9
Domestic corporate goods prices	Y-o-y % ch	3.2	-5.0	-2.2	-1.8	-5.5	-8.3	-4.7	-1.4	-1.6	-2.1	-2.4	-2.8
Consumer prices	Y-o-y % ch	1.2	-1.4	-1.2	0.0	-1.0	-2.3	-1.4	-0.8	-1.2	-1.3	-1.2	-1.1
Uncollateralized overnight call rate	%	0.09	0.10	0.10	0.09	0.11	0.10	0.10	0.10	0.10	0.10	0.10	0.10
Yield on newly-issued 10-yr JGBs	%	1.44	1.33	1.16	1.29	1.42	1.34	1.30	1.20	1.20	1.15	1.15	1.10
Nikkei average	JPY	10,802	9,850	10,700	7,930	9,294	10,141	9,800	10,000	10,200	10,500	10,800	11,000
Exchange rate	JPY/USD	100.5	92.0	93.0	93.6	97.3	93.6	89.0	88.0	90.0	91.0	93.0	95.0
Crude oil price (WTI nearest term contract)	USD/bbl	85.9	72.0	74.0	43.0	59.6	68.1	77.0	82.0	76.0	73.0	72.0	73.0

Notes: 1. The rates of change above are based upon actual amounts and hence may differ from the rates of change in public releases.

2. Ordinary profits are based upon the *Financial Statements Statistics of Corporations by Industry (all industries)*.

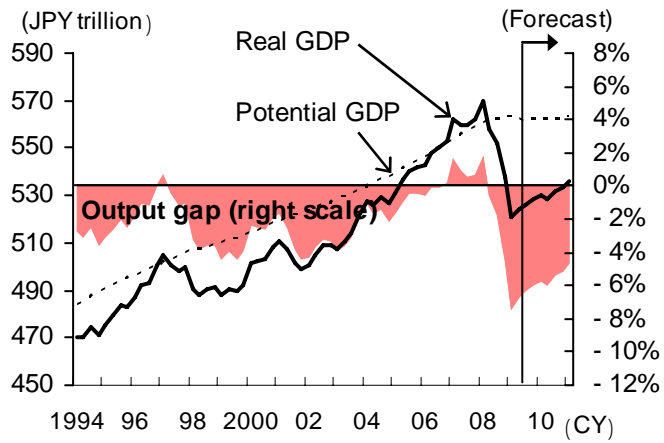
3. Consumer prices exclude fresh food.

4. Quarterly data on the unemployment rate, new housing starts and current account balance are seasonally-adjusted.

5. Of the finance-related indices, the uncollateralized overnight call rate refers to the rate at the end of term and all others are averages during the relevant terms.

Sources: Made by MHR based upon Cabinet Office, *Preliminary Quarterly Estimates of GDP*, Ministry of Economy, Trade and Industry, *Indices of Industrial Production*, Ministry of Finance, *Financial Statements Statistics of Corporations by Industry, Quarterly*, Ministry of Internal Affairs and Communications, *Labor Force Survey, Consumer Price Index*, Ministry of Land, Infrastructure, Transport and Tourism, *Current Survey on Construction Statistics*, Bank of Japan, *Balance of Payments, Corporate Goods Price Index, Financial and Economic Statistics Monthly, Foreign Exchange Rates*, Japan Bond Trading Co., Ltd., *Latest Daily JGB Rates*, Nikkei Inc. and Bloomberg.

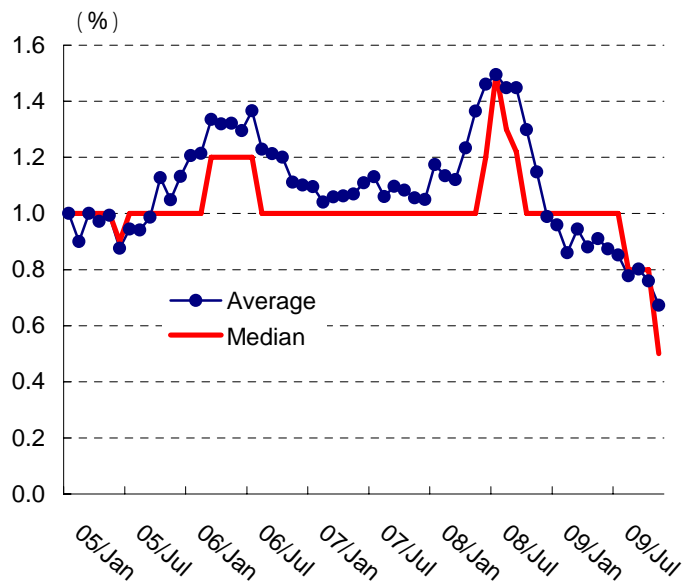
[ Chart 3: The output gap ]



Note: Estimates by MHRI.

Sources: Cabinet Office, Ministry of Economy, Trade and Industry, Ministry of Internal Affairs and Communications, and others.

[ Chart 4: Average expected inflation rate (next 10 years) ]



Source: QUICK Survey System.

[ Chart 5: Outlook on the US economy ]

(%)

	2008	2009 (Forecast)	2010 (Forecast)	2008		2009 (Forecast)		2010 (Forecast)	
				1H	2H	1H	2H	1H	2H
GDP	0.4	-2.6	1.9	0.5	-2.3	-4.8	1.8	2.3	1.4
Personal consumption	-0.2	-0.7	1.2	0.0	-2.5	-0.7	1.4	1.0	1.5
Housing investment	-22.9	-19.3	1.3	-25.7	-17.7	-31.1	9.1	7.7	-17.2
Capital investment	1.6	-18.0	0.8	2.9	-7.8	-28.0	-5.3	2.4	3.8
Inventory investment (USD100 million)	-259	-1,235	-442	-183	-336	-1,371	-1,099	-551	-333
Government consumption	3.1	2.1	2.2	2.6	3.6	0.6	3.7	1.9	1.5
Net exports	-4,943	-3,608	-3,760	-5,135	-4,751	-3,585	-3,631	-3,708	-3,812
Exports	5.4	-10.2	6.5	6.4	-4.2	-21.6	10.1	6.2	3.8
Imports	-3.2	-14.1	6.1	-3.4	-6.7	-26.8	8.6	5.8	4.1
Domestic final demand	-0.4	-2.6	1.4	-0.3	-2.5	-4.7	1.4	1.5	1.3
Unemployment rate	5.8	9.2	9.9	5.2	6.5	8.7	9.8	10.0	9.8
Nonfarm payrolls (per month, 1,000 persons)	-189	-398	12	-82	-297	-600	-195	9	16
PCE deflator<y-o-y change>	3.3	0.1	1.4	3.7	3.0	0.1	0.2	1.6	1.1
Core PCE deflator <y-o-y change>	2.4	1.5	1.0	2.5	2.3	1.7	1.4	1.2	0.8
Current account balance (USD100 million)	-7,061	-4,176	-4,517	-3,670	-3,391	-2,032	-2,144	-2,200	-2,317
<as a percentage of nominal GDP>	-4.9	-2.9	-3.1	-5.1	-4.7	-2.9	-3.0	-3.0	-3.1

Notes: 1. Calendar-year figures refer to the rate of change from the previous year. Half-year term figures refer to the rate of change from the previous half-year term (annualized).  
2. The shaded columns are forecasts.  
3. Regarding the current account balance, figures for the half-year terms are adjusted for seasonal factors and the calendar-year figures are the totals. The percentages of nominal GDP are annualized.

Sources: US Department of Commerce, US Department of Labor, MHRl.

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